No. 20,204

IN THE

United States Court of Appeals

For the Ninth Circuit

In the Matter of
DANILO A. MAYORGA,
Debtor.

Appeal from the Judgment of the United States District Court for the Northern District of California, Southern Division
Honorable Alfonso J. Zirpoli, Judge

APPELLANT'S OPENING BRIEF

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A. INTRODUCTION

1. PLEADINGS

A Petition for confirmation of a Wage Earner's Plan under Chapter XIII of the Bankruptcy Act was filed on December 22, 1964.

On January 18, 1965, Hon. Lynn J. Gillard, Referee in Bankruptcy, made an order denying confirmation, and on January 21, 1965, filed his Opinion and Order confirming the earlier order. (See p. 1 of the Record.)

On February 1, 1965, appellant filed a Petition for Review (See p. 5 of the Record), and on February 2,

1965, Referee Gillard filed his Certificate on Petition for Review. (See p. 14 of the Record.)

On May 5, 1965, Hon. Alfonso J. Zirpoli, Judge of the District Court, made his Order affirming the Order of Referee Gillard (See p. 32 of the Record), and the Notice of Appeal was filed on May 19, 1965. (See p. 34 of the Record.)

Jurisdiction is granted to the District Court by Section 39c of the Bankruptcy Act (USC, Title 11, Section 67c), which provides that:

> "A person aggrieved by an order of a referee may, within ten days after the entry thereof . . . file with the referee a petition for review of such order by a judge . . ."

The Court of Appeals is given jurisdiction by Section 24 of the Bankruptcy Act (USC, Title 11, Section 47), which provides that:

> "(a) The United States Courts of appeals . . . are hereby invested with appellate jurisdiction from the several courts of bankruptcy in their respective jurisdictions in proceedings in bankruptcy . . .
>
> "(b) Such appellate jurisdiction shall be exercised by appeal and in the form and manner of an appeal."

The Petition for Review is set forth on page 5 of the Record.

2. STATEMENT OF FACTS

On June 13, 1960, the appellant (as Jose Danilo Mayorga) filed a voluntary petition in bankruptcy in this Court, Bankruptcy Proceeding No. 58137; he received his discharge on June 1, 1961.

On December 22, 1964, Mayorga filed his petition for relief under Chapter XIII of the Bankruptcy Act, in a proceeding in which he proposed to pay all of his creditors in full. At the first meeting of creditors held on January 18, 1965, the Referee found that the plan was feasible (i.e., that the debtor's income was sufficient to make the monthly payments proposed by his plan and that such payments, if continued as proposed, would pay his creditors in full within three years) but denied confirmation on the ground that Sections 656 [11 U.S.C. Section 1056] and 14(c)(5) [11 U.S.C. Section 32] of the Bankruptcy Act prohibited the same since the debtor had received a discharge in a proceeding under the Bankruptcy Act commenced within six years of filing the petition.

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3. STATEMENT OF QUESTION INVOLVED

The question presented is whether a petitioner under Chapter XIII of the Bankruptcy Act who has, within six years of filing his petition, commenced another proceeding under the Bankruptcy Act and received thereunder a discharge, may obtain confirmation of his proposed plan under Chapter XIII, if the plan requests merely an extension of time in which

to pay his debts in full, and does not seek a composition with his creditors.

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4. SPECIFICATION OF ERRORS

There is only one error to be urged on this appeal and that is based upon the ruling of the District Court that Section 656 of the Bankruptcy Act [11 U.S.C., Section 1056] and Section 14(c)(5) of the Bankruptcy Act [11 U.S.C., Section 32(c)(5)] require denial of confirmation in such a case; it is the position of appellant that if the plan meets the other requirements of the Act, there is no necessity for denial because of a prior petition in bankruptcy with respect to which a discharge has been granted.

B. ARGUMENT

1. SECTION 14(c)(5) OF THE BANKRUPTCY ACT [11 U.S.C. 32(c)(5)] DOES NOT BY ITS TERMS PROHIBIT CONFIRMATION OF THE PLAN.

Section 14(c)(5) of the Bankruptcy Act provides that the court shall grant a discharge upon a petition in bankruptcy:

> ". . . unless satisfied that the bankrupt . . . has in a proceeding under this act commenced within six years prior to that date of the filing of the petition in bankruptcy been granted a discharge."

The argument is made that in a proceeding under Chapter XIII of the Bankruptcy Act the court could not grant a discharge, and that therefore the Wage Earner's Plan proposed in such a proceeding may not be confirmed. But this section refers to the filing of a petition in bankruptcy, and not necessarily to the filing of any other petition under the Bankruptcy Act. A petition for a Wage Earner's Plan under Chapter XIII of the Act is not a petition in bankruptcy, and if it seeks merely an extension of time within which the debtor may pay his obligations, it does not even necessarily, as will be shown, necessitate a discharge.

The filing of a petition for an extension under Chapter XIII appears not to be a petition in bankruptcy within the meaning of Section 14(c)(5), because the debtor seeks the benefits of Chapter XIII in order to aid him in paying all of his bills in full, and not to be discharged from paying them.

That Congress recognized this distinction is apparent from a consideration of House of Representatives Report No. 1409, (75th Congress, First Session [1938]), reporting the Chandler Act of 1938, which created both Wage Earner's Plans and the present form of Section 14(c)(5). That report, in discussing proposed Section 14(c)(5) said:

> "... it may be thought that this provision should be expanded to constitute the confirmation of an extension ... but in the case of an extension, it is contemplated that debts shall be paid in full ..."

A number of cases have held that the difference between a petition seeking an extension, and one seeking a composition or discharge, are so vital that a prohibition in one instance would not act as a bar in the other. An early case making this distinction is *In re Thompson,* 51 Fed. Supp. 12 (District Court, Western District, Virginia [1943]). This case considered the Congressional intent expressed in House of Representatives' Report No. 1409 (supra), and allowed the debtor to file a voluntary petition only three years after his having filed a petition for an extension under Chapter XIII.

This appears also to be the first case in which the Court considered the social advantages of allowing the confirmation of a plan under these circumstances; in holding that a discharge pursuant to the first petition was not a bar to confirmation of the second, the Court said:

> "It is to be remembered that a bar to a second discharge in bankruptcy within six years had a definite and desirable purpose. It was to prevent the creation of a class of habitual bankrupts, to prevent debtors from going through bankruptcy to escape payment of their debts whenever, and as frequently, as they chose . . . the reasons why a debtor should not be allowed to accomplish the result as frequently as he chooses have no application to the situation where a debtor offers to and does pay his debts in full."

The situation in that case was, of course, the reverse of the Chapter XIII-after-bankruptcy situation, but

a California court found its reasoning persuasive in the earliest recorded decision on this question in this state. In *In re Mahaley, Jr.,* 187 Fed. Supp. 229 (District Court, Southern District of California [1960]) the Court, after referring to the recognized conflict of opinion among the Referees in this matter, holds that Section 14(c)(5) of the Bankruptcy Act does not

> ". . . preclude confirmation of a Wage Earner Plan for *an extension only,* filed within six years of a discharge in ordinary bankruptcy." [Emphasis supplied].

The Court in this case appreciated the difference between the pro forma discharge contemplated by Section 660 of the Act, and the actual discharge provided for by Section 661.

The former (Bankruptcy Act, Section 660, 11 U.S.C. Section 1060) provides that:

> "Upon compliance by the debtor with the provisions of the plan, and upon the completion of all payments to be made thereunder, the court shall enter an order discharging the debtor from all his debts and liabilities provided for by the plan . . ."

The latter (Bankruptcy Act, Section 661, 11 U.S.C. Section 1061) provides that:

> "If at the expiration of three years after the confirmation of a plan the debtor has not completed his payments thereunder, the court may nevertheless, upon the application of the debtor and after hearing upon notice . . . enter an order

> discharging the debtor from all of his debts and liabilities provided for by the plan."

Under section 660, the debtor having paid all his bills, the court merely performs a ministerial function in entering a discharge; the debtor actually has no remaining debts at all. Under section 661, the discharge contemplated is similar to that sought in a straight bankruptcy proceeding.

In holding that a debtor under Chapter XIII might not be entitled to the latter form of discharge, although he would certainly be entitled to the former, the Court in *Mahaley* said:

> "Relief under Section 661 might, upon timely objection, be denied to any debtor who had received a discharge in bankruptcy within the six-year period."

As a practical matter, there is little chance of the Courts being imposed upon, or being beguiled into granting an undeserved Section 661 discharge, because such a discharge can be granted only ". . . after hearing upon notice", and any unpaid creditor would, of course, have an opportunity to remind the Court of a prior discharge in bankruptcy.

In considering the difference between relief afforded by a composition and that afforded by a discharge, the court said:

> "Since a composition contemplates a partial release from a debtor's obligations, confirming a plan for composition within six years of a discharge in ordinary bankruptcy would be tanta-

mount to allowing two 'discharges' within six years. Such a rationale is totally inapplicable in a case where, as here, the debtor is to receive no release until he has satisfied his creditors in full."

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2. SECTION 14(c)(5) OF THE BANKRUPTCY ACT [11 U.S.C. 32(c)(5)] IS INAPPLICABLE TO PROCEEDINGS UNDER CHAPTER XIII.

Section 602 of the Bankruptcy Act (11 U.S.C., section 1002) holds inapplicable to Chapter XIII proceedings any provisions of Chapters I through VII of the Act which are inconsistent with or conflict with the provisions of Chapter XIII.

The Court in *Mahaley* said:

> "The purposes underlying Section 14(c)(5) are so inconsistent with the purposes underlying relief by extension under Chapter XIII that said section is inapplicable in the instant proceedings."

A case denying confirmation of a Wage Earner's Plan within six years of a prior confirmation is *In re Bingham,* 190 Fed. Supp. 219 (District Court, Kansas [1960]). It is not clear as to the nature of the first wage earner's plan, but it appears to have been a composition.

The Court seems to base its rather vague decision on the supposed danger of habitual use of Chapter XIII proceedings and a lack of interest and possible depreciation of a property that might result during the extension period.

The appeal was dismissed as moot because the debtor had paid all creditors before the appeal was heard.

Bingham was not followed by the same court in *In re Autry,* 204 Fed. Supp. 820 (District Court, Kansas [1962]), which held the first extension plan not a bar to a second filed within six years of the first. The court said that a literal interpretation of Section 14(c)(5) shows that it is to prevent *release* from indebtedness only, thus recognizing its inapplicability to a case in which only an extension is sought.

The *Bingham* case was expressly disapproved in *In re Sharp,* 205 Fed. Supp. 786 (District Court, Western District, Missouri [1962]). That case was identical with the one at bar, and allowed the debtor to have confirmation of his Chapter XIII plan although he had had a discharge in straight bankruptcy within six years.

The Court said: "It would do violence to the general purpose of Chapter XIII", to fail to confirm on that ground, and that "debtors should be encouraged to pay debts, not discharge them."

On that rationale, Section 14(c)(5) was held not applicable to Chapter XIII proceedings, on the grounds of the inconsistency specified in section 602 of the Bankruptcy Act.

In re Bingham was also overruled by the Circuit Court of Appeals in *In re Holmes,* 309 Fed. 2d 748 [1962]. In that case, it was held that the inclusion of wage earner's plans by way of composition in section

14(c)(5), and its "noticeable silence" with respect to extensions was "decisively significant".

The Court concludes by saying that the Chapter XIII extension plan ". . . asserted here does not come within the letter or spirit of the bar of Section 14(c)(5)."

The *Holmes* case was extended to cover facts as at bar in *Edins v. Helzberg's Diamond Shops, Inc.,* 315 Fed. 2d 223 (Circuit Court of Appeals, 10th District [1963]); the debtor there sought confirmation of a Chapter XIII plan within the period of the six-year rule, and the Court held on authority of *Holmes* that he could receive confirmation notwithstanding the prior discharge.

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3. SECTION 656 OF THE BANKRUPTCY ACT [11 U.S.C. 1056] DOES NOT PROHIBIT CONFIRMATION OF THE PLAN.

Prior to 1952, Section 366 of the Bankruptcy Act [11 U.S.C. section 766] relating to proceedings under Chapter XI provided that:

> "The court shall confirm an arrangement if satisfied that . . . (4) the debtor has not been guilty of any of the acts . . . which would be a bar to the discharge of *a bankrupt.*" [Emphasis supplied]

At that time, Section 656 was identical, except that the words "confirm a plan" were substituted for "confirm an arrangement."

In 1952, Section 656 was changed to read:

> "The court shall confirm a plan if satisfied that . . . (3) the debtor has not been guilty of any of

the acts which would be a bar to the discharge of *the bankrupt.*" [Emphasis supplied]

(In Collier on Bankruptcy, 1964 Amendments, as well as in most of the cases, this distinction has apparently been missed, because the law is incorrectly quoted as reading "a bankrupt" instead of "the bankrupt".)

At the same time, Section 366 was subjected to substantial revision, but the words "a bankrupt" were not changed to "the bankrupt".

Although no reason for the change is given in committee reports of the amendments, it may be inferred that by the use of the definite article in Section 656, Congress intended to make clearer the requirement that the bar to confirmation provided for by Sections 656 and 14(c)(5) was intended to apply only to those persons who were seeking to escape their debts wholly or in part.

A debtor seeking an extension under Chapter XIII cannot be "the bankrupt" referred to in Section 656. He is a debtor seeking to pay his debts in full, and indeed, usually seeking specifically to avoid becoming a bankrupt.

Thus, whereas Section 366 provides that confirmation may be denied if the debtor has committed any of the acts which will be a bar to the discharge of a bankrupt, whether or not the petitioning debtor is actually a bankrupt, Section 656, by use of the words "the bankrupt" rather than "a bankrupt", requires that

the debtor be in fact the bankrupt, or at least seeking bankrupt relief of discharge or composition. This is not the case where the debtor expects to pay all his creditors in full under an extension.

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4. RULES RELATING TO PLANS OF ARRANGEMENT UNDER CHAPTER XI ARE NOT APPLICABLE TO WAGE EARNERS' PLANS UNDER CHAPTER XIII.

A number of cases have applied to proceedings under Chapter XIII the same rules which prevail in proceedings under Chapter XI. It is submitted that the same rules do not apply because of the difference in the relief sought and in the remedies provided.

Section 371 of the Bankruptcy Act [11 U.S.C., Section 771] provides, with respect to arrangements under Chapter XI, that "the confirmation of an arrangement shall discharge a debtor from all his unsecured debts and liabilities provided for by the arrangement . . ."

Section 660 of the Bankruptcy Act [11 U.S.C., Section 1060] provides, not that the debtor is discharged upon confirmation of the arrangement, but that "upon compliance by the debtor with the provisions of the plan and upon completion of all payments to be made thereunder, the court shall enter an order discharging the debtor from all his debts and liabilities provided for by the plan . . ."

The crucial difference between the two sections, and between the rationale of arrangements under Chapter

XI and plans under Chapter XIII is that in the former, a discharge is granted upon confirmation of the arrangement, and in the latter, there is no discharge until the debtor has complied with all the provisions of the plan and paid all his bills.

We are not now concerned with Section 661 [11 U.S.C., Section 1061] which provides that at the end of three years a debtor may, under certain circumstances, have a discharge even if he has not complied with the plan. That section is an effective method by which the court may control the habitual bankrupt, for it may, at its discretion, refuse a discharge to the non-paying debtor and thus leave the creditors free to pursue him through normal remedies. It is for this reason that the leading case, relating to the filing of an arrangement under Chapter XI within six years of the filing of a Petition in Bankruptcy with respect to which a discharge has been granted, that is, in *In re Jensen; People's Finance Co. v. Jensen,* 200 Fed. 2d 58 (Circuit Court of Appeals, Seventh Circuit [1952]), is not authority for a situation such as is found in the case at bar.

In that case, the debtor filed the Chapter XIII extension petition but refiled the same plan as a Chapter XI petition, because his income exceeded the maximum allowable under Chapter XIII at that time.

The court refused confirmation primarily because the debtor pledged future wages under the plan, allowable under Chapter XIII but not allowable under Chapter XI.

However, it also held that the discharge provisions in Section 371 [11 U.S.C., section 771] brought the case within Section 14(c)(5) and confirmation therefore barred because the petition was filed within six years of a discharge in straight bankruptcy.

The majority went on to note that Chapter XI contains no such provision as Section 660 in Chapter XIII, thus recognizing that confirmation has a different effect under the two chapters, and implying, though not holding, that the result might have been different had Chapter XI contained a provision similar to Section 660.

The dissent in *Jensen* shows that the reason for the six-year rule is to prevent repeated discharges of debtors by payment of only a small percentage of their debts and that when ". . . the agreement is to pay the debts in full, the reason for the rule fails."

The *Jensen* case was criticized and not followed in *In re Verlin,* 148 Fed. Supp. 660 (Eastern District, New York [1957]), in which a debtor who had filed a Chapter XI extension plan within six years but had made only thirteen percent of the scheduled payments was nevertheless allowed to receive a discharge in involuntary bankruptcy.

In affirming this case, the Circuit Court of Appeals, in *Fishman v. Verlin,* 255 Fed. 2d 682 [1958] cited House of Representatives Report No. 1409 (supra), and said, ". . . especially significant is the distinction between an extension and composition found in the legislative history of the Chandler Act . . ."

It is submitted that the *Jensen* case is applicable to Chapter XI only and not to Chapter XIII and is questionable authority even within that limited scope.

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5. CASES IN WHICH CONFIRMATION HAS BEEN DENIED HAVE FAILED TO RECOGNIZE THE SPECIAL NATURE OF RELIEF BY WAY OF EXTENSION.

In *In re Schlageter,* 319 Fed. 2d 821 (Circuit Court of Appeals, Third Circuit [1963]), a case embodying the same principle as the one at bar, the Court refused to confirm a plan under Chapter XIII in which an extension was sought, because the debtor had received a discharge in bankruptcy within six years.

The court said that Sections 656, 660 and 661 are in pari materia and must be construed together and that discharge is ". . . essential to adequate relief under the statutory scheme." The court also relies on the fact that no judgment may be entered against the debtor during operation of the plan and places great stress on the discharge provisions of Section 661.

It should be noted that the court fails to take into account the discretionary nature of the discharge under Section 661 as an effective safeguard against habitual resort to the Bankruptcy Act.

The court also fails to mention the prior cases of *Autry, Sharp, Edins,* or *Holmes,* and, in addition, fails to differentiate between a composition and an extension, and the payment-in-full aspect of an extension.

Nevertheless, the case was followed in *In re Nicholson,* 224 Fed. Supp. 772 (District Court, Oregon

[1963]) and in *In re Fontan,* 227 Fed. Supp. 973 (District Court, Eastern District, Mississippi [1964]), which made the same error as *Schlageter* and ignored the distinction between extensions and compositions, and failed to recognize the prerequisites to discharge under Section 661.

In *Fontan,* the court said:

> "No adjudication is contemplated, but it cannot be said that discharge will not follow the execution of an approved plan. It is not a mere deferment or postponement of a debtor's obligations which is requested and will be granted in a proper proceeding."

The court, by these words, seems to confuse composition and extension and treats the latter as though it were not the mere extension of time or deferred time of payment that it actually is.

The most recent case, *In re Perry,* 340 Fed. 2d 588 (Circuit Court of Appeals, Sixth District [1965]), a case on the same facts as those at bar held that a distinction between extension and composition is "immaterial" and that exemptions should be made by Congress, not the courts. The District Court in the instant case also uses this latter point as decisive.

The court in *In re Perry* did not recognize that the Congress made such an exemption when it created Chapter XIII, as shown by House of Representatives Report No. 1409 (supra). It may be assumed that the Court would have decided differently had the House Report been called to its attention.

C. CONCLUSION

There can be no question but that although relatively few cases touch upon this precise subject, those which do are in hopeless conflict. In the Ninth Circuit there is conflict within the Circuit itself; in the Southern District of California *In re Mahaley* (supra) was held that there may be confirmation of a plan under Chapter XIII in spite of a discharge in Bankruptcy within six years; in the Northern District of California, the case at bar, with identical facts, was held that there can be no confirmation.

It is submitted that the cases allowing confirmation are the better reasoned and more clearly reflect the intention of the legislators based upon such notes as are available.

It has been shown that neither of the statutes referred to in the Order Affirming the Order of the Referee prohibit confirmation of the Plan, that section 14(c)(5) is not applicable to proceedings under Chapter XIII; that the rules applicable to Chapter XI proceedings ought not to be applied to Chapter XIII proceedings, and that the cases adverse to the position contended for by appellant have failed to appreciate the peculiar nature of the relief sought by a petition for an extension under Chapter XIII.

The danger sought to be prevented by Section 14 (c)(5) of the Bankruptcy Act is the creation of an habitual class of bankrupts: extensions under Chapter XIII operate specifically to prevent bankruptcy.

By the operation of Section 661, Chapter XIII specifically prevents the habitual use of its provisions by those who do not pay their debts in full.

It is submitted that denial of confirmation in the case at bar would frustrate the intent of Congress that well-meaning wage-earners be able at all times to seek the assistance of the courts in securing an extension in which to pay their bills in full.

Dated, Oakland, California,
September 7, 1965.

RALPH NATHANSON,
Attorney for Appellant.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

RALPH NATHANSON.